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# PROTECTING NONSHAREHOLDER INTERESTS IN THE MARKET FOR CORPORATE CONTROL: A ROLE FOR STATE TAKEOVER STATUTES

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Frank J. Garcia\*

In the wake of the Supreme Court's controversial decision in *CTS Corp. v. Dynamics Corp. of America*,<sup>1</sup> which upheld Indiana's takeover statute,<sup>2</sup> the role of state legislatures in regulating the market for corporate control<sup>3</sup> has been a particularly acute

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1. 481 U.S. 69 (1987).

2. The statute under review, Indiana's Control Share Acquisition Chapter, IND. CODE ANN. § 23-1-42-1 to -11 (West 1989), is one of five basic types of statutes that states use to regulate takeovers. See *infra* notes 114-18 and accompanying text.

3. The "market for corporate control," a term introduced by Henry Manne in his seminal article, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965), is commonly used to refer to the widespread purchase and sale of controlling blocks of common stock through the mechanism of the tender offer. A tender offer "is a public offer made by the [acquiring] firm to the . . . shareholders of the target firm to purchase a certain number, usually a controlling interest, of the target firm's voting shares at a specific price." Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J.L. ECON. 371, 371 n.1 (1980). The offer will generally include a substantial premium over market price to tendering shareholders and will be open for a limited time. *Id.* Manne's thesis is that these transactions, and related transactions such as mergers and non-tender offer acquisitions, constitute a distinct public market in "corporate control," here viewed as a valuable asset independent of other aspects of the enterprise. Manne, *supra*, at 112. In Manne's view, the primary force behind this market is the potential for gain inherent in the target company's assets, realizable through the substitution of more efficient management. *Id.* at 112-13. The disciplinary effect attributed to this market, although abrupt, is considered salutary. See, e.g., Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984). Coffee notes Judge Friendly's characterization of the takeover bid as "the sharpest blade for the improvement of corporate management." *Id.* at 1159 n.30 (quoting Friendly, *Make Haste Slowly*, in COMMENTARIES ON CORPORATE STRUCTURE AND GOVERNMENT 525, 532 (D. Schwartz ed. 1979)).

This basic proposition, that corporate control is traded to realize potential firm value, underlies the position of modern advocates of minimally regulated takeover activity. See, e.g., Davis, *Epilogue: The Role of the Hostile Takeover and the Role of the States*, 1988 WIS. L. REV. 491, 503-04 (discussing the neoclassical position). Opponents of this position accept Manne's basic position, but question whether this market does increase the firm's value or society's welfare, and regardless of this, whether and to what degree the inter-

area of concern. Despite widespread activity in state legislatures,<sup>4</sup> numerous judicial opinions,<sup>5</sup> and considerable academic commentary,<sup>6</sup> no clear consensus has emerged regarding either the social benefits of increased takeover activity or the legitimacy of state regulation.<sup>7</sup> The debate has developed two stable but fundamentally opposed camps: those in favor of a deregulated (or minimally regulated) market for control,<sup>8</sup> and those who support substantial regulation toward a marked decrease in takeover activity.<sup>9</sup> The latter group itself is divided on the validity of a state role in regulating this market; some advocate such a role,<sup>10</sup> and others favor federal preemption.<sup>11</sup>

ests of other participants in corporate enterprise are injured by this activity. See, e.g., Coffee, *supra*, at 1199-250; Grippo, *In Defense of State Takeover Laws*, 8 N. ILL. U.L. REV. 273, 276-77 (1988); Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1 (1987).

4. See *infra* note 74 and accompanying text; see also *infra* notes 114-18 and accompanying text.

5. See *infra* Part II.C.

6. For an exhaustive list of commentators, see Note, *Stakeholder versus Stockholder: The Director's Proper Constituency in a Contest for Corporate Control*, 15 WM. MITCHELL L. REV. 475, 475 n.1 (1984) (authored by Marc C. Luther). For a recent symposium on issues in corporate governance, see *Symposium: Issues in Corporate Governance*, 22 U. MICH. J.L. REF. 1 (1988).

7. Federal regulation of this market is accomplished primarily by the Williams Act, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1988), which added sections 13(d)-(e) and 14(d)-(f) to the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1988). The Williams Act, which seeks to protect investors by requiring full disclosure by persons acquiring corporate control, adopts an approach similar to the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1988), and to the Securities and Exchange Act of 1934. Its disclosure and procedural requirements are intended to offer investors the opportunity to make informed decisions without altering the balance to favor either bidders or targets. For a critical view of the Williams Act's success in this neutrality, see Jarrell & Bradley, *supra* note 3.

8. E.g., Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Jarrell & Bradley, *supra* note 3; Macey, *State Anti-Takeover Legislation and the National Economy*, 1988 WIS. L. REV. 467; Jensen, *The Takeover Controversy: Analysis and Evidence* in KNIGHTS, RAIDERS, AND TARGETS: THE IMPACT OF THE HOSTILE TAKEOVER 314 (1988). For a useful exposition and overview of this position from a sympathetic commentator, see Note, *Fear of the Hostile Takeover: Having Tamed and Reined the Beasts, State Regulations Would Kill Them as Well*, 14 J. CORP. L. 133 (1988) (authored by Bradley William Kragel).

9. E.g., Coffee, *supra* note 3, at 1250-96; Grippo, *supra* note 3, at 277; Lipton, *supra* note 3.

10. E.g., Booth, *The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635 (1988); Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1 (1986); Shipman, *The Case for Reasonable State Regulation of Corporate Takeovers: Some Observations Concerning the Ohio Experience*, 57 U. CIN. L. REV. 507 (1988).

11. Lipton, *supra* note 3; see also Davis, *supra* note 3, at 503. For the view that federal preemption offers little solace to those concerned with latent state protectionism, see Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 U. CIN. L. REV. 457, 468-75 (1988).

This Note advances three basic propositions in support of the view that states should play a role in regulating takeover activity. First, the policy debate over the social benefit of an active and relatively unregulated market for control has been mischaracterized as a debate over statistics, when actually it is a conflict over norms. Arguments in favor of takeover activity are generally built on an agency theory of the firm that assumes the sole operative duty of firm management is shareholder wealth maximization.<sup>12</sup> Rather than simply a debate over whether takeovers maximize shareholder wealth, however, the disagreement concerns the fundamental issue of corporate governance, the choice of a norm for corporate decision making.<sup>13</sup> The corporate norm should reflect the public's answer to the problem of balancing shareholder interests against the concerns of nonshareholder participants in the firm, such as management, employees, creditors, suppliers and, perhaps, the local community. The argument is really over whether the exclusive concern for shareholder wealth maximization is, or should be, the corporate norm, and if not, what norm better expresses the public's judgment concerning the protection of all participants in corporate activity.

Second, within this controversy over norms, sound public policy and the development of corporate law favor a norm that considers nonshareholder constituencies of the corporation. The current ambiguity surrounding the scope of the fiduciary duty of a target board in a takeover context reflects continuing controversy over the extent to which the board may consider the interest of nonshareholders. Contrary to the view taken in much of the current literature, statutes and case law recognize the board's responsibility to consider the interests of nonshareholders.

Third, the market for corporate control, while arguably profitable for target company shareholders, fails to protect adequately the interests of other constituencies. Instead, the market for cor-

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12. See, e.g., Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259 (1982) (stating that arguments for reform of corporate governance fail to understand the economic theory underlying the corporate form, i.e., agency cost theory); Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 113 (1987) (noting that state takeover statutes are troublesome because they are inconsistent with "the core goal of corporation law—the maximization of equity share prices").

13. Webster's Dictionary defines "norm" as "a principle of right action binding upon the members of a group and serving to guide, control or regulate proper and acceptable behavior." WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 806 (1987). In the present context, the group referred to is the board of directors, and the behavior concerned is the conduct of corporate activity.

porate control actually offers incentives to shareholders to place nonshareholder groups in jeopardy. As a result of this breakdown in corporate governance, states have a legitimate role to play in protecting nonshareholder interests. The most plausible way to protect those interests through state takeover law is the business combination statute,<sup>14</sup> such as the Wisconsin statute<sup>15</sup> recently upheld by the United States Court of Appeals for the Seventh Circuit in *Amanda Acquisition Corp. v. Universal Foods Corp.*<sup>16</sup> Such laws restore to the board a voice in takeover negotiations and provide it with an effective opportunity to speak for nonshareholders.

Part I of this Note describes a phenomenon of modern corporate activity first identified over fifty years ago as the "separation of ownership and control." This separation gives rise to the need for a governing corporate norm; recognizing the normative aspect of this phenomenon has direct implications for the takeover debate.

Part II analyzes the problem of a target board's fiduciary duty as the modern version of the fundamental normative issue of corporate law. It argues that the norm of shareholder wealth maximization, assumed as the starting point by those most in favor of an active and minimally regulated control market, is compelling in its simplicity but misleading in its characterization of the law. A view of fiduciary responsibility that includes consideration for nonshareholder interest, while conceptually more complex and practically more difficult, is more consistent with both the development of the law and the realities of corporate dynamics.

Part III analyzes and critiques the hostile takeover for its effect on nonshareholder interests. Although the socioeconomic effects of takeovers are unclear, there appears to be a genuine threat posed to nonshareholders in the form of a wealth transfer to shareholders. This occurs through the uncompensated imposition of high, unbargained-for risk levels on middle management, employees, creditors and local communities.

Finally, Part IV argues that the state can play a legitimate role in regulating the market for control to safeguard nonshareholder interests. By restoring the board of directors to a negotiating role in takeovers, business combination statutes,

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14. See *infra* notes 125-33 and accompanying text.

15. WIS. STAT. ANN. § 180.726 (West Supp. 1989).

16. 877 F.2d 496 (7th Cir.), *cert. denied*, 110 S. Ct. 367 (1989).

such as those in Delaware,<sup>17</sup> New York,<sup>18</sup> and Wisconsin,<sup>19</sup> can function as a means of protecting or compensating nonshareholders for the imposition of increased levels of risk.

## I. THE SEPARATION OF OWNERSHIP AND CONTROL

In 1932 Adolf Berle and Gardiner Means produced the founding study of the modern publicly held corporation, *The Modern Corporation and Private Property*.<sup>20</sup> In that study, they documented the development of the corporate form of enterprise organization, from publicly chartered special purpose organizations to small private businesses in which the shareholders were active owners, and finally into large social institutions. In these large companies, the wealth of a great number of individuals is aggregated under the direct control of a few professional managers, whose shareholdings are generally insignificant.<sup>21</sup> This centralization of wealth under the direction of a few individuals has transformed the unified concept of property into a weak form of nominal ownership and strong de facto control.<sup>22</sup>

This separation of ownership and control makes possible both the success of the corporate form and its gravest abuses. Chief among its advantages is that it enables tremendous resources to be assembled and managed towards a unified set of goals.<sup>23</sup> This feat would be otherwise impossible because most small businesses would lack necessary capital and large enterprises would become hopelessly mired in the competing claims of thousands of "owners." Thus, the effective concentration of economic power can be seen as the genius of the modern publicly held corporation.

The dissolution of the concept of property into components of control and beneficial ownership also creates a difficult problem. Under the "old" system of property, an owner's conduct was guided by his own interest, limited only by the law and the competition of the marketplace.<sup>24</sup> Under the modern system, however, the individual owner's initiative is replaced by the direc-

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17. DEL. CODE ANN. tit. 8, § 203 (Supp. 1988).

18. N.Y. BUS. CORP. LAW § 912 (McKinney 1986 & Supp. 1990).

19. WIS. STAT. ANN. § 180.726 (West Supp. 1989).

20. A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

21. *Id.* at 3-6.

22. *Id.* at 7.

23. *Id.* at 46.

24. *Id.* at 2-3, 333-39.

tion of a team of professional managers, who are not usually owners in any significant sense.<sup>25</sup> The immediate consequence of this substitution is the potential for a conflict of interests between the components of control and beneficial ownership.

Therefore, the fundamental question posed by the separation of ownership and control is: "For what purpose and to whose benefit shall the corporation be governed?"<sup>26</sup> The separation has placed control in a position of responsibility over vast human and material resources that, in the aggregate, have a significant impact on the community. As a result, the challenge for corporate law is to develop a standard of conduct that establishes for what purpose and to whom control shall be accountable. Only once such a norm is developed can the law proceed to articulate methods of ensuring accountability.

Commentators in favor of a deregulated market for control assume the separation of ownership and control as a starting point and proceed to analyze the relative positions of ownership and control as an agency relationship between shareholders as principals, and management as agents.<sup>27</sup> The argument then leaps forward to an analysis of management's faithfulness to the shareholders' interests, which are assumed to be solely the maximization of their wealth. Shareholder wealth maximization would seem a reasonable first choice for a standard of conduct, because it transfers the traditional concept of property rights to the now-passive owners. Under this view, management is strictly a trustee for the security owner.

Such theories, however, ignore the fundamental uncertainty about the nature and objectives of corporate activity that underlies the debate over takeover regulation.<sup>28</sup> Berle and Means accurately foresaw that the revolution in the concept of property wrought by the separation of ownership and control would create a situation in which neither ownership nor control can claim exclusive discretionary authority.<sup>29</sup> The essential consequence of this separation is that because the nature of ownership has changed, one should not simply presume the interest of the new "owners" to be the sole reference point for guiding a complex, powerful institution with a broad impact on society.

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25. *Id.* at 84-118.

26. *Id.* at 9.

27. Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Coffee, *supra* note 3, at 1154-55.

28. Johnson & Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846, 855 (1989).

29. A. BERLE & G. MEANS, *supra* note 20, at 356.

Passive, widely dispersed shareholders, by limiting their liability and foregoing a significant degree of control, have surrendered the right to have the corporation operated in their sole interest. They have released the community from the obligation to protect their interest to the full extent of the traditional property doctrine.<sup>30</sup> The security holder is now an "investor," rather than an "owner," losing all the normative connotations of ownership. As an investor, she is certainly entitled to protection, but not exclusively so. In fact, other parties make "investments" in the corporate entity, such as management, employees, creditors, and local communities.

Through the mechanism of state law, the separation of ownership and control creates an entirely new legal entity that involves the interrelation of a wide diversity of interests: "owners" who supply capital; workers who create; consumers who give value; local communities that provide infrastructure; and managers, who exercise authority. The concentration of economic power, and the dilution of ownership that accompanies this diversity of interests, sharpens the issue of accountability for the protection of these interests.<sup>31</sup>

The result is that the state, as representative of the community, is in a position to demand that enterprise be conducted in a manner that best serves the interests of the community as a whole.<sup>32</sup> The state, through its corporation laws, should develop a governing norm which will best serve these interests. As Berle and Means noted, "[w]hen a convincing system of community obligation is worked out and is generally accepted . . . the passive property right of today must yield to the larger interests of society."<sup>33</sup>

The argument in favor of takeover activity is generally empirical in form: If takeovers maximize shareholder returns, then they are good; if state regulation or corporate defensive measures decrease shareholder wealth, then they are bad.<sup>34</sup> Such empirical protakeover arguments are, in fact, making a veiled normative claim that exclusive concern for shareholder wealth maximization is the rule of conduct that the state has chosen (or

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30. *Id.* at 355.

31. *Id.* at 356.

32. *Id.*

33. *Id.*

34. For example, "[p]erhaps a *complete answer* to the question of whether takeovers benefit the natural economy is contained in the evidence of the gains realized by those lucky shareholders whose firms are the subject of a tender offer." Macey, *supra* note 8, at 471 (emphasis added). In view of the discussion in the text, perhaps not.



ought to choose) as best serving the public interest. Takeovers, these advocates argue, are wealth-maximizing tools, and therefore serve the public good.

The empirical argument actually addresses an important, but secondary, question. The primary issue for the takeover debate is whether states have decreed, or ought to decree, through their corporation laws that exclusive concern for shareholder wealth maximization is the corporate norm that best advances the public interest.<sup>35</sup> Because this issue has not been clearly settled in favor of shareholder wealth maximization, state efforts to regulate takeovers in order to protect the interests of nonshareholders should proceed.

## II. THE CORPORATE NORM—FOR WHOM ARE MANAGERS TRUSTEES?

The advent of "junk bond, bust-up takeovers,"<sup>36</sup> the defensive responses to such takeovers, and the dangers posed to a variety of constituents have focused debate again on the issue that divided Professors Berle and Dodd<sup>37</sup> over fifty years ago: For whom are corporate managers trustees?<sup>38</sup>

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35. In reviewing a target board's refusal to stimulate an auction for the company, the court in *TW Servs. Inc. Shareholders Litig.*, 1989 Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,180 n.14 (Del. Ch. Mar. 2, 1989), mused: "Questions of this type call upon one to ask, what is our model of corporate governance? . . . [R]esolution of these questions . . . seems inescapably to involve normative questions . . . ." Takeover advocates could argue that an exclusive concern for shareholder wealth maximization is the accepted norm in corporate law, and reflects the judgment on behalf of the public that it is in society's best interest to run its corporations solely for the profits of its shareholders. See, e.g., Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. Times, Sept. 13, 1970, § 6 (Magazine), at 32. One could then proceed to an empirical study of the wealth effects of takeovers in a consistent manner. However, it is essential to note that the terms of the debate have been transformed. Shareholder wealth maximization, and consequently the deregulation of the market for control, is a normative choice governed by consideration of the public good, and not a fundamental aspect of the corporate landscape. It must be argued as a normative choice, and it can be criticized as such.

36. "In such a takeover, junk bonds (non-investment grade securities with a high rate of return) allow a raider to make a 100% cash offer for a target of almost any size. If successful in obtaining a controlling interest, the raider merges the target into itself and sells assets of the target to help finance the acquisition." Lipton, *supra* note 3, at 11.

37. Professors Berle and Dodd addressed this issue from differing viewpoints as early as 1932 and had a continuing dialogue. See *infra* notes 41-48 and accompanying text.

38. Lipton, *supra* note 3, at 35 (noting the resurgence of this issue).

### A. *Historical Background of the Corporate Norm*

The early, leading case on the question of the corporate norm is *Dodge v. Ford Motor Co.*,<sup>39</sup> a 1919 Michigan Supreme Court case. In *Dodge*, the plaintiffs challenged Henry Ford's plan to use retained earnings for such purposes as building a hospital for employees, rather than distributing them as dividends to shareholders. As a basic statement of the corporate norm, the court stated: "[A] business corporation is organized and carried on *primarily* for the profits of the stockholders."<sup>40</sup>

In holding stockholder profit to be the primary, but not exclusive goal, the court framed the task which was to confront judges and corporate governance commentators in the ensuing decades. The challenge was to articulate a model of corporate governance that would preserve the primacy of shareholder interests while ensuring the board's freedom, perhaps even duty, to consider nonshareholder interests.

This attempt was made, in part, through a debate conducted between Professors Berle and Dodd that spanned over twenty years. Dodd argued that corporate managers could legitimately serve as trustees for a wide variety of constituencies, including shareholders, labor, and the general public.<sup>41</sup> Such a view is difficult to justify on the theory of a business corporation as an aggregate of shareholders, with management serving them as trustees. Echoing Berle and Means' earlier work, however, Dodd emphasized that the corporation was a distinct legal entity, differing from the aggregate of its individuals both in law and in fact.<sup>42</sup> Giving weight to the legal status of the corporation as an independent entity gives rise to a concept of fiduciary duty running to the entity, rather than simply to the shareholders. Management's duty was "no longer . . . to take from labor for the benefit of capital, nor to take from the public for the benefit of both, but to administer wisely and fairly in the interest of all."<sup>43</sup>

Berle's resistance to this expanded view of management's responsibilities was rooted in his concern over the potential for

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39. 204 Mich. 459, 170 N.W. 668 (1919).

40. *Id.* at 507, 170 N.W. at 684 (emphasis added). The court proceeded to order a dividend of \$19 million dollars, but refused to enjoin Ford's planned expenditures. *Id.* at 487, 506-510, 170 N.W. at 677, 684-85.

41. Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

42. *Id.*

43. *Id.* at 1155 (quoting from Address by Owen D. Young, Jan. 1929, quoted in J. SEARS, *THE NEW PLACE OF THE STOCKHOLDER* 209 (1929)).

management to turn any latitude towards its own ends.<sup>44</sup> The potential for abuse required that management's fiduciary duty be drawn narrowly around shareholder interests unless and until a suitably precise alternative could be developed.<sup>45</sup>

In 1954, Berle conceded that "the argument has been settled [at least for the time being] squarely in favor of Professor Dodd's contention."<sup>46</sup> Case law recognized that a board of directors' fiduciary duty was not breached by consideration of responsibility to a wider community.<sup>47</sup> Berle later noted that "modern directors are not limited to running business enterprise for maximum profit, but are in fact and recognized in law as administrators of a community system."<sup>48</sup>

### *B. The Modern Context: The Corporate Norm Under Scrutiny*

The dramatic increase in takeover activity has called into question this basic view of the corporate norm. Generally, advocates of an active market for control make a fundamentally different assumption regarding the corporate manager's fiduciary duty: that wealth maximization of shareholders is the sole legitimate goal of management.<sup>49</sup>

From this view, hostile takeovers are the ultimate means of maximizing shareholder wealth by reducing agency costs.<sup>50</sup> Alternatively, takeovers are defended as the attempt to exploit the potential for synergistic gains, which are reflected in the shareholders' premium.<sup>51</sup> Either approach leads naturally to the conclusion that state takeover laws and legal rules allowing defen-

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44. Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932).

45. *Id.*

46. A. BERLE, *THE 20TH CENTURY CAPITALIST REVOLUTION* 169 (1954).

47. See, e.g., *A.P. Smith Mfg. Co. v. Barlow*, 13 N.J. 145, 98, A.2d 581, *appeal dismissed*, 346 U.S. 861 (1953).

48. Berle, *Foreword to THE CORPORATION IN MODERN SOCIETY* at xii (E. Mason ed. 1959).

49. See, e.g., Macey, *supra* note 8, at 469 (arguing that statutes allowing the board of directors to consider nonshareholder interests in developing a tender offer response "abrogate the fiduciary duties of care and loyalty traditionally owed to shareholders"). For additional examples of this view, see *supra* note 12.

50. See Fischel, *supra* note 12, at 1261-65.

51. Bradley, Desai & Kim, *Synergistic Gains from Corporate Acquisitions and Their Division Between the Stockholders of Target and Acquiring Firms*, 21 J. FIN. ECON. 3 (1988).

sive tactics violate the fundamental corporate norm by decreasing shareholder wealth.<sup>52</sup>

Proponents of the shareholder wealth maximization view argue further that to include broader concerns within management's fiduciary duty will lead to inefficiency by disturbing the market mechanism, promoting arbitrary management decision making, and distorting the allocation of resources. Target directors would be ill-suited to protect nonshareholders from any putative dangers from takeover activity, these proponents contend, because "[t]hey lack political legitimacy and the capacity to balance goals of profit maximization with the concerns of nonshareholders."<sup>53</sup> In any event, they argue, nonshareholder constituencies can adequately protect themselves through negotiation, contract and litigation.<sup>54</sup>

The response to these protakeover arguments has been threefold. The first set of arguments challenges the substantive claims made on behalf of the market for control by questioning the efficiency of the market underlying share prices, the validity of the disciplinary hypothesis, or the reality of synergistic gains.<sup>55</sup> The second approach recognizes that some takeovers may function as claimed, but stresses that takeovers also create risks and losses for shareholders and nonshareholders as well as for the economy and American society as a whole.<sup>56</sup> These risks and losses are considered legitimate concerns in the formulation of public policy.<sup>57</sup>

The third criticism is the most central attack on the protakeover theorists. It asserts that to assume an exclusive concern for shareholder wealth maximization as the corporate norm fundamentally mischaracterizes the nature of corporate responsibility both in fact and in law. These critics argue that "the shareholders-only view ignores the reality that other constituencies share the risk and are vital to the success of corporate activity."<sup>58</sup> For example, Professor Summers argues that employees are as much members of the enterprise as the shareholders;<sup>59</sup> in fact, employ-

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52. Romano, *supra* note 12, at 113.

53. Note, *Takeover Dangers and Nonshareholders: Who Should Be Our Brothers' Keeper?*, 1988 COLUM. BUS. L. REV. 301, 338 (authored by Christopher J. Smart); see also Note, *supra* note 6.

54. Lipton, *supra* note 3, at 162.

55. Coffee, *supra* note 3, at 1163-67, 1207.

56. *Id.* at 1221-50.

57. *Id.*

58. Lipton, *supra* note 3, at 37.

59. See Summers, *Codetermination in the United States: A Projection of Problems and Potentials*, 4 J. COMP. CORP. L. & SEC. REG. 155 (1982).

ees may have made a greater investment through years of service, are less able to withdraw, and probably have a greater stake in the future of the enterprise than the widely dispersed shareholders.<sup>60</sup> The same reasoning can be applied to other interests, such as creditors, customers, suppliers, and local communities, that play an integral role in the success of the corporate enterprise.<sup>61</sup>

Moreover, in the context of a takeover bid, the contracting process may not protect these interests because it is a prospective attempt to establish the terms of a future relationship.<sup>62</sup> Such a mechanism is less effective where parties cannot accurately anticipate future contingencies. Shareholders who tender their holdings may receive huge premiums for forcing a much higher level of risk, both on the firm and on constituent groups, than that for which the parties originally bargained.<sup>63</sup>

### C. *The Current Legal Status of Nonshareholder Interests*

The fiduciary responsibility of target management in the context of a takeover bid is the "most unresolved doctrinal issue of contemporary corporate law."<sup>64</sup> Within this ambiguity, however, courts have recognized that the scope of a board's fiduciary duty to the corporation includes consideration of the interests of nonshareholders.

The leading authority recognizing management's responsibility to consider nonshareholder interest is *Unocal Corp. v. Mesa Petroleum Co.*,<sup>65</sup> from the Supreme Court of Delaware, the leading corporate law jurisdiction. In *Unocal*, the court upheld a target's self tender that excluded the bidding firm.<sup>66</sup> In reviewing the board's decision, the court noted that it was the responsibility of the directors to consider the effect of the bid on the corporate enterprise, including "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."<sup>67</sup>

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60. *Id.* at 170.

61. Lipton, *supra* note 3, at 37-38.

62. *Id.* at 38-39.

63. Coffee, *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-ups*, 1988 Wis. L. Rev. 435, 447-48.

64. Coffee, *supra* note 3, at 1216.

65. 493 A.2d 946 (Del. 1985).

66. *Id.* at 958-59.

67. *Id.* at 955.

Federal courts also have found it within management's purview to consider interests beyond the shareholders. In *Herald Co. v. Seawell*,<sup>68</sup> the United States Court of Appeals for the Tenth Circuit upheld the Denver Post's defensive responses to a takeover bid from a large newspaper chain.<sup>69</sup> In upholding the legitimacy of the board's concern for other constituencies, the court noted that "[s]uch a newspaper corporation, not unlike some other corporations . . . has an obligation to those people who make its daily publication possible."<sup>70</sup>

Similarly, a federal district court in the Southern District of New York, another prominent corporate law jurisdiction, stated clearly the propriety of management's concern for other constituencies in the face of a takeover bid:

A corporation with a perceived threat of dismemberment of large divisions of the enterprise, employing thousands of employees, owes substantial regard for their pension benefits, and in the case of loyal management, severance benefits. These legitimate concerns for their past conduct of the enterprise and its requirements need not be left to the goodwill of an unfriendly acquirer of corporate control in the jungle warfare involving attempted takeovers. The exercise of independent, honest business judgment . . . is the traditional and appropriate way to deal fairly and even-handedly with both the protection of investors, on the one hand, and the legitimate concerns and interests of employees and management of a corporation who service the interests of investors, on the other.<sup>71</sup>

Recent decisions in the state and federal courts, however, have underscored the ambiguity which plagues this area of the law. For example, in *Revlon, Inc. v. MacAndrews & Forbes Holding, Inc.*,<sup>72</sup> the Delaware Supreme Court limited the target board's freedom to consider noteholder's interests to noninterference with contractual rights. Because this limitation applies only when the breakup of the corporation is inevitable, it does not squarely reverse *Unocal*, though it does call into question the extent of protection nonshareholders' interests will receive.<sup>73</sup>

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68. 472 F.2d 1081 (10th Cir. 1972).

69. *Id.* at 1100.

70. *Id.* at 1095.

71. *GAF Corp. v. Union Carbide Corp.*, 624 F. Supp. 1016, 1019-20 (S.D.N.Y. 1985).

72. 506 A.2d 173, 182-83 (Del. 1986).

73. Lipton, *supra* note 3, at 41.

Faced with such ambiguity in the case law, states have responded by amending their corporate codes to clarify the board's authority to consider nonshareholder interests.<sup>74</sup> For example, Pennsylvania's law establishing the fiduciary duty of a director was changed in 1986 to read:

In discharging the duties of their respective positions, the board of directors . . . may, in considering the best interests of the corporation, consider the effects of any action upon employees, upon suppliers and customers of the corporation, and upon communities in which offices . . . are located. . . . The consideration of those factors shall not constitute a violation of fiduciary duty.<sup>75</sup>

If there is any consensus in the law today on a corporate fiduciary's responsibilities, it is reflected in the American Law Institute's Principles of Corporate Governance.<sup>76</sup> Section 2.01, in setting forth "the objective and conduct of the business corporation," is basically a restatement of the corporate norm. The corporation should conduct its activities "with a view to enhancing corporate profit and shareholder gain."<sup>77</sup> However, "whether or not corporate profit and shareholder gain are thereby enhanced," the corporation may also take into account "ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business."<sup>78</sup>

The phrase "with a view to" does not reflect the absolute mandate for shareholder wealth maximization advocated by the protakeover school. The additional language regarding ethical considerations sets forth the legal right of a corporation and its directors to pursue conduct that may not maximize shareholder gain, provided it is appropriate to the responsible conduct of business. While such language is not an outright endorsement of the legitimacy of concern for nonshareholder interests, a strong argument can be made that such concerns are indeed "appropriate and should be extended to the takeover context."<sup>79</sup>

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74. For example, Maine, Minnesota, Missouri, Ohio, and Pennsylvania now have such statutes. See ME. REV. STAT. ANN. tit. 13-A, § 716 (Supp. 1989); MINN. STAT. ANN. § 302A.251(5) (West Supp. 1990); MO. ANN. STAT. § 351.347(1.)(4) (Vernon Supp. 1990); OHIO REV. CODE ANN. § 1701.59(E) (Anderson Supp. 1989); 15 PA. CONS. STAT. ANN. § 1721(c) (Purdon Supp. 1990).

75. 42 PA. CONS. STAT. ANN. § 8363(b) (Purdon Supp. 1989).

76. PRINCIPLES OF CORPORATE GOVERNANCE § 2.01 (Tent. Draft No. 2, 1984). See Coffee, *supra* note 3, at 1220 (noting consensus on this issue).

77. *Id.*

78. *Id.*

79. Coffee, *supra* note 10, at 84.

The American Law Institute (ALI) analysis supports the contention that management acts within its lawful responsibilities when it considers the effects of a takeover on nonshareholder groups. But to what extent this consideration can limit or displace shareholder interest is difficult to fix precisely. The most likely setting for courts to consider the issue is in a review of defensive tactics under the business judgment rule.<sup>80</sup> Although it would be unwise for nonshareholder interests to trump shareholder interests, disregarding the consideration of nonshareholder interests entirely would contradict both legal authority and the reality of corporate dynamics. It is more likely that in close cases, management should be able to consider threats to nonshareholder interests as justifying a course of conduct that yields roughly similar returns to shareholders as a takeover bid.<sup>81</sup> While inclusion of nonshareholder interests may render a court's business judgment analysis more complex, the ALI provides clear support for a board's concern for nonshareholder constituencies in the context of a takeover attempt.

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80. The business judgment rule is a presumption that after reasonable investigation, disinterested directors have adopted a course of action that they honestly and reasonably believe in good faith will benefit the company. Unless a plaintiff proves that the directors have failed to do this in a material respect, a court will not step in and second-guess their business judgment nor will it find the directors liable for damages arising from the decision. *See, e.g., Smith v. Van Gorkom*, 488 A.2d 858, 871-73 (Del. 1985); Farrar, *Business Judgment and Defensive Tactics in Hostile Takeover Bids*, 15 CAN. BUS. L.J. 15, 19-20 (1989).

Delaware courts have been active in attempting to work out the application of the business judgment rule to directors' decisions to adopt defensive tactics. In a takeover context, the burden shifts onto the directors, as defendants, to satisfy the court that they had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed," and that the defensive measures were "reasonable in relation to the threat posed." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985). This burden is met by showing good faith and reasonable investigation. *Id.* Consideration of nonshareholder interests could conceivably affect the determination both of whether there were reasonable grounds to believe there was a "danger to corporate policy," and the reasonableness of the actions taken in response to that threat.

81. For example, in *Revlon, Inc. v. MacAndrews & Forbes Holding, Inc.*, 506 A.2d 173, 184 (Del. 1986), the court invalidated a lock-up with a third-party bidder, Forstmann Little & Co., on the grounds that the lock-up ended an active auction, although it assured a price to shareholders of \$57.25, higher than the then-current takeover bid of \$56.25 per share. If the court had recognized as legitimate the board's attempt, through the lock-up, to protect bondholders by supporting failing note prices, it would have been hard-pressed not to see the lock-up as, on the whole, a desirable transaction.



## III. TAKEOVER EFFECTS ON NONSHAREHOLDER INTERESTS

Empirical evidence seems overwhelmingly in favor of the view that the takeover is a wealth maximizing event for the target shareholders.<sup>82</sup> Nevertheless, such evidence does not resolve conclusively the debate over takeover regulation for two reasons. First, it can still be argued that shareholder premiums reflect, at least in part, wealth transfers from nonshareholder groups such as bondholders or employees.<sup>83</sup> Second, as argued above,<sup>84</sup> the law recognizes the responsibility of target management to consider the effects of takeovers on nonshareholders as well.

The effects of takeovers on nonshareholder groups can be roughly split into two categories: the "socioeconomic" effects, such as plant closings and lost jobs; and the "intrafirm" effects, which subject the firm's constituencies to a higher-than-bargained-for level of risk.

One commentator has written that "virtually every state can demonstrate the 'bloody shirt' effects of the waves of hostile takeovers."<sup>85</sup> Such effects include plant closings, employee layoffs, firm liquidations, relocations, and the selling of assets.<sup>86</sup> These events have resulted in severe and adverse consequences to individuals, families, and communities dependent on the stable and continuous operation of local corporations.<sup>87</sup>

Arguments in favor of takeover regulation on these grounds can be justly criticized. Much of the adverse impact on nonshareholder groups may simply be the normal consequences of the essential pursuit of economic efficiency, as nonproductive or excess plants, resources, and personnel are eliminated.<sup>88</sup> Even if many adverse consequences are economically necessary, however, this does not guarantee that they are always so.<sup>89</sup>

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82. See, e.g., Jensen, *supra* note 8.

83. See, e.g., Coffee, *supra* note 3.

84. See *supra* Part II.C.

85. Schumann, *Introduction*, 8 N. ILL. U.L. REV. 197, 199 (1988) (Symposium on State Corporate Anti-Takeover Legislation).

86. *Id.*

87. Grippo, *supra* note 3, at 277.

88. Macey argues further that the "available evidence" indicates that takeover bidders don't fire all workers or unilaterally lower wages. Macey, *supra* note 8, at 478. Spin-off transactions, the argument goes, generally preserve workers and seldom result in liquidations. If they do, Macey concludes the national employment picture doesn't change, since local workers lose, but out of state workers win. *Id.* at 478-79.

89. The case in favor of takeover activity as enhancing and creating social welfare, beyond shareholder premiums, has not been conclusively settled. See *supra* notes 54-55 and accompanying text.

Furthermore, the tremendous negative impact of takeovers has created substantial local constituencies<sup>90</sup> whose concerns and grievances are legitimate objects of attention by state policy-makers. Even assuming that takeovers maximize shareholder wealth, legislators must still reckon with the cost to these other groups that such maximization will entail. Such concern is particularly warranted, given the possibility that these losses to nonshareholder groups may involve little or no increase in economic efficiency.<sup>91</sup>

With regard to intrafirm effects, the challenge has been to develop a coherent set of answers to whether nonshareholder losses exist, to what extent they are offset by shareholder gains, and to what compensation, if any, the law should provide.<sup>92</sup> Although concentrated academic study of the intrafirm effects of takeovers on nonshareholder groups has only recently begun,<sup>93</sup> preliminary analysis suggests that the structure of a takeover will inevitably involve negative consequences within the firm on nonshareholder interests.<sup>94</sup>

From the perspective of nonshareholder groups, the market for control is fundamentally flawed. Not only is it designed to protect the shareholders, but it may even function as an incentive for the shareholders to injure nonshareholder interests. According to the agency theory of the firm, management incentives such as stock options and, ultimately, the discipline of the market for control itself, are designed to align management interests with shareholder interests, which are not equivalent with the interests of nonshareholder groups.<sup>95</sup> The structure of a tender offer encourages a potentially serious conflict of interest between shareholders and nonshareholder groups.<sup>96</sup>

The central problem raised within the firm for nonshareholders by the prospect of a hostile takeover is the level of risk.<sup>97</sup> Proponents of the agency theory of the firm see only the shareholders as bearing the residual risk of the firm's production in-

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90. Schumann, *supra* note 85, at 199-200.

91. Coffee, *supra* note 3, at 1249.

92. Davis, *supra* note 3, at 516; Johnson & Millon, *supra* note 28, at 854.

93. Davis, *supra* note 3, at 516.

94. Coffee, *supra* note 63, at 447.

95. Commentators on all sides of the debate recognize the folly in equating shareholder and nonshareholder interests. See, e.g., Coffee, *supra* note 10, at 104; Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decision Making*, 57 CALIF. L. REV. 1, 16 (1969); Fischel, *supra* note 12, at 1266-67 & n.24.

96. See Coffee, *supra* note 10, at 12.

97. *Id.* at 16-24.

vestment decisions.<sup>98</sup> Therefore, only the shareholders are in need of governance protection, with other interests protected by the external market.<sup>99</sup> Employees, suppliers, pensioners, and lower level managers also have an economic interest in the firm, however, and share in the residual risk. Local communities have in many cases made significant firm-specific investments in developing the infrastructure to support local corporations.<sup>100</sup> These interests can be adversely affected by an increase in risk borne by the firm. Thus, this increase in risk breaches the shareholders' implicit contracts with the other stakeholders regarding the expected levels of risk under which the stakeholders were to perform their duties and invest their firm-specific capital.<sup>101</sup> In effect, the takeover results in a breakdown of this contracting process.

This breach occurs both before and after a takeover. Pretakeover management has the incentive to accept riskier production investment decisions on the chance that this will boost share prices past the point of a takeover threat.<sup>102</sup> One result of this increase in risk is to transfer wealth from bondholders, who face a decrease in the value of their investment when management incurs additional risk that promises the bondholders no additional return.<sup>103</sup> Unlike creditors, who can price protect themselves *ex ante* for such risk, other nonshareholder interests lack mechanisms for protection even though the security of their investment is placed in jeopardy by higher risk levels.<sup>104</sup>

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98. *Id.* at 11-12.

99. *Id.*

100. Coffee, *supra* note 10, at 72.

101. One good account of this central problem of risk is Professor Coffee's "implicit contracts" analysis. Coffee, *supra* note 63, at 446-48. On this view, one of the functions of the corporation, when viewed as a nexus of contracts, is to support "implicit contracts" reached between shareholders and nonshareholders who participate in or interact with the corporation. Out of their long-term continuing relationships, the parties develop certain expectations with regard to, for example, the length and security of their employment or supply relationship, the acceptable level of debt financing, or the duration of the corporation's presence within the community. Davis, *supra* note 3, at 515-16; *see also* Coffee, *supra* note 63, at 447-48 & n.44.

102. Coffee, *supra* note 10, at 61-63.

103. One response on behalf of noteholders is the use of "poison pill" bond provisions, in which the corporation, in return for a lower initial interest rate, pledges to raise the interest rate paid on outstanding bonds in the event of certain changes in control, including takeovers. The use of such provisions is a response to "bondholder[s]" concerns that have cropped up over the last year about having their bonds lose a great deal of value in a takeover situation." *See* Weiss, *U.S. Companies Reap Benefits from New "Poison Pill" Bond Provisions*, Portland Daily J. Com., June 18, 1990, at 12 col. 3 (quoting Jeffrey M. Jackson, managing director of corporate finance for American Airlines).

104. *Cf.* Coffee, *supra* note 3, at 1248.

When a takeover bid is made, the threat to nonshareholders becomes acute. The shareholders are offered a lucrative incentive to breach their implicit contracts with the stakeholders in the pursuit of maximum shareholder gain. Employees and other constituencies will face an increased risk to job security if the takeover succeeds. While senior management can have recourse to "golden parachutes,"<sup>105</sup> it is unlikely that firms will have shouldered the burden of higher wages or severance-related compensation programs for middle management or the rank and file. In addition to the threat of liquidation or retrenchment, employees are endangered by the higher levels of debt incurred in the acquisition and borne by the newly structured, highly leveraged firm. If not fired outright, middle management and employees face continued employment under increased levels of risk from a transaction to which they did not consent and from which they received no compensation.<sup>106</sup>

States should be seen as the ultimate residual risk bearers, the insurers for the losses that limited liability spares the shareholders.<sup>107</sup> A state may suffer increased welfare rolls and end up partially funding tort-creditors if the corporation fails. Plant closings and layoffs can ultimately fall upon the state as welfare and unemployment insurance payments. Local communities that make firm-specific investments in infrastructure are likewise vulnerable to the level of risk accepted by such firms.<sup>108</sup>

In summary, the hostile takeover, although apparently wealth-maximizing for target shareholders, presents a serious threat of wealth transfers from nonshareholding constituencies. One form of transfer is the uncompensated increase in risk borne by creditors, middle level management, employees and local communities. Far from protecting these groups, the structure of the takeover gives shareholders a tremendous incentive to maximize their wealth at the cost of breaching their implicit contracts with these stakeholders. Viewed in this light, the premium that induces the breach reflects, at least in part, funds that should in some form be allocated to compensate other stakeholders. Because the implicit contracting process has broken down, however, noncontracting means are needed to protect these risk-bearers.

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105. "Golden poarachutes" are "severance contracts that compensate managers for the loss of their jobs in the event of a change in control." Jensen, *supra* note 8, at 340.

106. See Coffee, *supra* note 10, at 72-73.

107. *Id.* at 72.

108. *Id.*

#### IV. THE ROLE OF THE STATES IN PROTECTING NONSHAREHOLDER INTERESTS

The development of the law of fiduciary duty and the underlying corporate norm suggest that it should be the board of directors' role to safeguard nonshareholder interests.<sup>109</sup> It is a unique feature of the hostile takeover, however, that it is designed to sidestep the board, which is otherwise active in major structural changes.<sup>110</sup> The ability of the board to carry out its responsibilities to nonshareholders is thus singularly excluded. Generally, the board remains involved only in the context of defensive measures, such as adopting a shareholders' rights plan, or "poison pill,"<sup>111</sup> or negotiating a leveraged buyout. These tactics function either to deter a takeover altogether, or to stimulate an auction which maximizes the premium to shareholders. Neither effect will function to protect nonshareholder interests should a takeover occur.

The gap in legal protection of nonshareholder interests created by the structure of a hostile takeover justifies state intervention. Some state legislation has clearly been aimed at protecting nonshareholder interests,<sup>112</sup> but the bulk of such

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109. Some commentators have suggested that nonshareholder constituencies should be given board representation. See, e.g., Conard, *The Supervision of Corporate Management: A Comparison of Development in European Community and United States Law*, 82 MICH. L. REV. 1459 (1984); Williamson, *Corporate Governance*, 93 YALE L.J. 1197 (1984); Note, *Employee Codetermination: Origins in Germany, Present Practice in Europe, and Applicability to the United States*, 14 HARV. J. ON LEGIS. 947 (1977) (authored by J. Bautz Bonanno).

However, members of these constituencies may not have any business skill regarding structural change issues simply by virtue of their role as employee or creditor. Eisenberg, *supra* note 95, at 18-19. In addition, there is the risk that board meetings could degenerate into stalemates between representatives of opposing interests. *Id.* Finally, such representation would seem unnecessary, given the fact that the law recognizes the responsibility of the board, as presently constituted, to take cognizance of these concerns.

110. Advocates of the efficacy of the takeover consider this aspect a prime virtue. See, e.g., Note, *supra* note 53, at 313-30. Even granting this, it is nevertheless a structural problem that such a mechanism for removing entrenched management creates the risk that not all voices within the corporation will be heard in a takeover context.

111. When triggered by a hostile tender offer, the "flip-in" provision of a second-generation shareholders' rights plan, or poison pill, effects an abrupt and extreme dilution of the target's equity, unless the preferred stock issued under the plan is redeemed by the target board. See, e.g., *Grand Metro., PLC v. Pillsbury Co.*, 558 A.2d 1049, 1051 n.2 (Del. Ch. 1988) (discussing a poison pill provision). It is this extreme dilution of equity which would make the pill so hard for an interested bidder to "swallow."

112. Coffee, *supra* note 10, at 93 (citing provisions which clarify the scope of a board's fiduciary duty to include nonshareholder interests and business combination statutes such as Wisconsin's recent law).

legislation has been ostensibly designed to safeguard shareholders.<sup>113</sup>

There are currently five basic types of state takeover statutes: disclosure laws, designed to give shareholders information relevant to their decision to tender;<sup>114</sup> fair price laws, which regulate the second step of two-step transactions;<sup>115</sup> business combination statutes, which prohibit certain transactions for a period of years after a takeover that was not approved by the board *ex ante*;<sup>116</sup> appraisal laws, which guarantee nontendering shareholders a judicially determined "fair value";<sup>117</sup> and control share acquisition statutes, which prevent an acquirer from exercising the voting rights of its shares without a separate majority vote by the remaining shareholders.<sup>118</sup>

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113. The controversial history of state legislative efforts in this area began on March 3, 1968, when Virginia enacted the first state takeover statute. 1968 Va. Acts ch.119 (repealed 1989). Thirty-seven states proceeded to adopt so-called "first-generation" statutes until the Supreme Court's 1982 decision in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), which struck down the Illinois Business Take-Over Act, ILL. REV. STAT. ch. 121½, para. 137.51-.70 (repealed 1983). Booth, *supra* note 10, at 1638 n.8.

Following *MITE*, twenty-two states adopted some form of "second-generation" statute, attempting in part to avoid the commerce clause problems that undermined the Illinois statute. Booth, *supra* note 10, at 1637 n.8. These efforts reached a turning point in 1987 when the Supreme Court upheld Indiana's Control Share Acquisition Chapter, IND. CODE ANN. § 23-1-42-1 to -11 (West 1989), in *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987).

The Court's unexpected ruling in *CTS* ushered in the "third-generation" of state takeover legislation. The current arsenal of state takeover measures includes a mixture of second- and third-generation laws. See *infra* notes 114-18 and accompanying text. As of mid-1988, twenty-nine states had enacted one or more such statutes, including twelve since the April 1987 *CTS* decision. Schumann, *supra* note 85, at 200.

114. See, e.g., MINN. STAT. ANN. § 80B.01-.13 (West 1986 & Supp. 1990); N.Y. BUS. CORP. LAW §§ 1601-13 (McKinney 1986).

115. See CONN. GEN. STAT. ANN. §§ 33-374a to -374c (West 1987); FLA. STAT. ANN. § 607.108 (West Supp. 1988); GA. CODE ANN. §§ 14-2-232 to -235 (Supp. 1987); ILL. REV. STAT. ch. 32, para. 7.85 (1987); KY. REV. STAT. ANN. §§ 271B.12-200 to -220 (Michie/Bobbs-Merrill 1989); LA. REV. STAT. ANN. §§ 12:131-134 (West 1969 & Supp. 1990); MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to -603 (1985 & Supp. 1989); MICH. COMP. LAWS ANN. §§ 450.1776-1784 (West Supp. 1989); MISS. CODE ANN. §§ 79-25-1 to -7 (1989); N.C. GEN. STAT. §§ 55-75 to -79 (Supp. 1989); 15 PA. CONS. STAT. ANN. § 1409.1 (Purdon Supp. 1989); VA. CODE ANN. §§ 13.1-725 to -728 (1985 & Supp. 1988); WASH. REV. CODE § 23A.08.425 (1989); WIS. STAT. ANN. § 180.725 (West Supp. 1989).

116. See ARIZ. REV. STAT. ANN. §§ 10-1221 to -1223 (Supp. 1987); DEL. CODE ANN. tit. 8, § 203 (Supp. 1988); IND. CODE ANN. § 23-1-43-18 (West Supp. 1987); KY. REV. STAT. ANN. § 271B.12-210 (Michie/Bobbs-Merrill 1989); MINN. STAT. ANN. § 302A.673 (West Supp. 1990); MO. ANN. STAT. § 351.459 (Vernon Supp. 1990); N.J. STAT. ANN. §§ 14A:10A-1 to :10A-6 (West Supp. 1989); N.Y. BUS. CORP. LAW § 912 (McKinney 1986 & Supp. 1990); WIS. STAT. ANN. § 180.726 (West Supp. 1989).

117. See ME. REV. STAT. ANN. tit. 13A, § 910 (Supp. 1987); UTAH CODE ANN. § 16-10-76.5 (1987).

118. See ARIZ. REV. STAT. ANN. §§ 10-1211 to -1217 (Supp. 1989); FLA. STAT. ANN. § 607.109 (West Supp. 1989); IND. CODE ANN. § 23-1-42 (West Supp. 1989); LA. REV. STAT. ANN. §§ 12:135-140.2 (West Supp. 1990); MASS. GEN. LAWS ANN. ch. 110D, §§ 1-8 (West

Four of these types of laws function, either by design or default, to protect exclusively shareholders. The fair price, appraisal, and control share laws attempt to resolve the problem of coercion, either by regulating the second step of the two-tier bids, or by separating the passage of control to the bidder from the tendering of the shares. Disclosure statutes, such as New York's Security Takeover Disclosure Act,<sup>119</sup> specifically mandate the disclosure of a proposed takeover's impact on nonshareholders. Each of these kinds of statutes, however, is still an inadequate safeguard for nonshareholder interests, because each puts the information into the hands of those with the most incentive to disregard it.<sup>120</sup>

Despite the emphasis on protecting shareholders, it is this aspect of state takeover legislation that is the most vulnerable.<sup>121</sup> The available empirical evidence strongly supports the view that the successful completion of a hostile takeover is a wealth maximizing event for target shareholders.<sup>122</sup> Furthermore, it is questionable whether the "coercive effect" of tender offers on target shareholders remains anything more than an academic bogeyman, in light of the current predominance of cash any-and-all-shares tender offers, "self-help" remedies such as fair price charter amendments and poison pills, and the bid-up effect of an auction for control.<sup>123</sup>

The case for statutory intervention can more plausibly be made on behalf of nonshareholders than shareholders.<sup>124</sup> In addition to socioeconomic disruption, nonshareholders face in-

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Supp. 1990); MINN. STAT. ANN. § 302A.671 (West Supp. 1990); MO. ANN. STAT. § 351.407 (Vernon Supp. 1990); NEV. REV. STAT. § 78.3791 (Supp. 1987); N.C. GEN. STAT. §§ 55-90 to -98 (Supp. 1989); OHIO REV. CODE ANN. § 1701.831 (Baldwin 1988); OKLA. STAT. ANN. tit. 18, §§ 1145-1155 (West Supp. 1990); 1987 OR. REV. STAT. § 60.807 (1989); WIS. STAT. ANN. § 180.25(9) (West Supp. 1989).

119. N.Y. BUS. CORP. LAW §§ 1600-13 (McKinney 1985); see generally Note, *A Policy Analysis of New York State's Security Takeover Disclosure Act*, 53 BROOKLYN L. REV. 1117 (1988) (authored by Gregory G. Faragasso).

120. Booth, *supra* note 10, at 1673; see also *supra* note 95.

121. Coffee, *supra* note 63, at 438. Johnson and Millon go a step further, arguing that shareholder welfare is a meaningless standard against which to assess state takeover laws, in that the laws represent a deliberate rejection on the part of state legislators of the shareholder primacy model. Johnson & Millon, *supra* note 28, at 847-48.

122. See *supra* Part III.

123. Coffee, *supra* note 63, at 439.

124. See, e.g., Coffee, *supra* note 63, at 439-40; Davis, *supra* note 3, at 493. In fact, it has been suggested that concern for nonshareholders was the tacit premise for the *CTS* decision among many in the *CTS* majority. *Id.* at 517. This implication draws support from the fact that Powell, the writer of the *CTS* opinion, was clearly concerned with the plight of nonshareholders in his *MITE* concurrence. See *Edgar v. MITE Corp.*, 457 U.S. 624, 646-47 (1982) (Powell, J., concurring in part).

creased levels of uncompensated risk, as implicit contracts are breached by shareholders eager to secure handsome premiums. This increased risk creates a broad-based political constituency, consisting of managers, employees, and local communities, that is legitimately in need of legal protection because of the failure of corporate governance mechanisms to adequately protect these groups in the takeover context.

In addition to identifying the risks that the nonshareholder group faces, the implicit contract analysis also suggests how a state can respond effectively to this powerful and legitimate voice. From this perspective, one of the board's roles is to mediate among the legitimate expectations of the many corporate constituents.<sup>125</sup> This is not to suggest that the board is simply balancing different but equivalent interests. Rather, recognizing that the law places a priority on shareholders' claims, the board would be free in a takeover context to safeguard nonshareholders from the negative effects of efforts to increase shareholder wealth.<sup>126</sup>

Because the structure of a takeover circumvents the target board, state takeover statutes that function to restore to the board a voice in takeover negotiations can play an essential role in filling this gap in nonshareholder protection. Of the five current types of takeover laws, the law best suited to this end is the business combination statute.<sup>127</sup> By forcing a bidder to negotiate with the board or face serious restrictions following a takeover,

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125. See Coffee, *supra* note 63, at 449-50.

126. *Id.* at 440, 450-58.

127. New York's Business Combination Statute has served as the model for later second-generation statutes of this type. Johnson & Millon, *supra* note 28, at 850. For a list of other states' business combination statutes, see *supra* note 116. The essential sections of New York's law, N.Y. BUS. CORP. LAW § 912 (McKinney 1986), read:

§ 912(a)(10)

(10) "Interested shareholder", when used in reference to any resident domestic corporation, means any person (other than such resident domestic corporation or any subsidiary of such resident domestic corporation) that

(A)(i) is the beneficial owner, directly or indirectly, of twenty percent or more of the outstanding voting stock of such resident domestic corporation; or

(ii) is an affiliate or associate of such resident domestic corporation and at any time within the five year period immediately prior to the date in question was the beneficial owner, directly or indirectly, of twenty percent or more of the then outstanding voting stock of such resident domestic corporation . . . .

§ 912(a)(13)

(13) "Resident domestic corporation" means an issuer of voting stock which:

(A) is organized under the laws of this state; and

(B) either (i) has its principal executive offices and significant business operations located in this state; or (ii) has . . . at least two hundred fifty employees or twenty-five percent of the total number of all employees . . . employed primarily within the state; and



the business combination statute functions like a poison pill, restoring to the board an active role in the takeover process. As with the poison pill, the statutory penalties for failing to secure board approval will serve primarily as leverage to bring the bidder to the board and are not likely to be triggered.<sup>128</sup>

In contrast to the poison pill, the business combination statute can be defended not as a shareholders' rights plan, but as a

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(C) has at least ten percent of its voting stock owned beneficially by residents of this state.

§ 912(b)

(b) Notwithstanding anything to the contrary contained in this chapter . . . no resident domestic corporation shall engage in any business combination with any interested shareholder of such resident domestic corporation for a period of five years following such interested shareholder's stock acquisition date unless such business combination or the purchase of stock made by such interested shareholder on such interested shareholder's stock acquisition date is approved by the board of directors of such resident domestic corporation prior to such interested shareholder's stock acquisition date.

Wisconsin's business combination statute, recently upheld by the Seventh Circuit in *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496 (7th Cir.), *cert. denied*, 110 S. Ct. 367 (1989), is essentially identical to New York's law except that § 80.726(1)(j) lowers the threshold ownership for interested stockholders to 10%, and § 180.726(2) reduces the moratorium on unapproved combinations to three years. *Wis. STAT. ANN.* § 180.726 (West Supp. 1989).

Delaware's law, *DEL. CODE ANN.*, tit. 8, § 203 (Supp. 1988), which potentially is more significant due to Delaware's unique role in American corporate law, differs from New York's law in several important respects. Section 203(c)(5) lowers the threshold stock ownership for interested stockholders to 15%, and § 203(a) reduces the moratorium on unapproved combinations to three years. Section 203(a)(2) renders the statute inoperative where the bidder has succeeded in acquiring at least 85% of the target's outstanding shares, and § 203(b)(3) permits companies to opt out of the protection of the statute by amendment to the certificate of incorporation or bylaws.

Most importantly, Delaware's law contains no jurisdictional requirements analagous to § 912(a)(13) of the New York law. The significance of this omission will turn on the degree of emphasis courts place on such nexus requirements, essential to the Indiana statute upheld in *CTS*, because few publicly held Delaware corporations could meet these requirements. *Davis, supra* note 3, at 521-22. In *BNS, Inc. v. Koppers Co.*, 683 F. Supp. 458, 472-73 (D. Del. 1988), a judge rejected the need for any additional nexus requirements, while the court in *RP Acquisition Corp. v. Staley Continental, Inc.*, 686 F. Supp. 476 (D. Del. 1988), held that Delaware's substantial local interest in "preventing the corporate form from becoming a shield for unfair business dealing" rendered unnecessary any additional nexus requirements. *See also Davis, supra* note 3, at 522 n.119.

128. As a practical matter, tender offers for companies with a poison pill are conditioned on the board redeeming the pill as a result of negotiation or judicial determination. Bloomenthal, *Introduction to J. BRYAN, CORPORATE ANTI-TAKEOVER DEFENSES: THE POISON PILL DEVICE* at Intro.-3 (1989). Such negotiations increase the target shareholder's premium in a completed takeover. *See Lee, Poison Pills Benefit Shareholders by Forcing Raiders to Pay More for Targets, Study Says*, Wall St. J., Mar. 31, 1988, at 55, col. 3 (finding a 69% increase in premiums after adjusting for market conditions). Without board approval of a tender offer and the redemption of the poison pill, the cost can be so high as to make the acquisition virtually impossible. *See, e.g., Grand Metro., PLC v. Pillsbury Co.*, 558 A.2d 1049, 1051 n.2 (Del. Ch. 1988).

stakeholders' rights plan.<sup>129</sup> Its usefulness would not be in raising the shareholder's premium (although it might also have that effect), but in ensuring that nonshareholder concerns could receive appropriate attention. In order to accomplish this, the opportunity offered through the statute must be strongly tied to the board's responsibility to nonshareholders. One means of ensuring this would be to amend the corporation code to reflect the legislature's concern that boards include nonshareholder interests in these negotiations.<sup>130</sup>

Once reestablished in the negotiating process, the board would be free to consider nonshareholder interests. Even in the wake of a successful offer, these interests could be safeguarded. For example, the premium can be distributed among nonshareholder groups, in the form of parachutes for middle management and job retraining for laid-off workers, or as an agreement to retain local headquarters and limit plant closings.<sup>131</sup> As a last resort, if the offer were to proceed after the target board and the bidder failed to come to terms, statutory restrictions on business transactions following the successful bid could help to stabilize employment and the local community by preventing liquidations or spin-offs.

Viewed as a form of stakeholder protection, business combination statutes can restore to corporate governance an effective means of protecting the interests of nonshareholder constituents. So long as the board's responsibility to nonshareholders is taken seriously, such laws express a legitimate state effort to protect the nonshareholding constituents of its domestic corporations.<sup>132</sup> Such an effort is quite distinguishable from attempts to hold local industry captive or to protect influential corporations.<sup>133</sup> Finally, although the Supreme Court has not yet re-

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129. Johnson and Millon argue that a business combination statute cannot be interpreted as a shareholder protection act because its structure belies the rationale offered for shareholder protection in a takeover context and it is likely to have an across-the-board chilling effect on hostile bids, some of which may have been acceptable to target shareholders. Johnson & Millon, *supra* note 28, at 850-51.

130. For an example of movement in this direction, see *supra* note 74 and accompanying text.

131. Schumann, *supra* note 85, at 200.

132. Even so distinguished an opponent to takeover regulation as Judge Easterbrook recognizes the legitimacy of this role: "Skepticism about the wisdom of a state's law does not lead to the conclusion that the law is beyond the state's power, however. . . . Unless a federal statute or the Constitution bars the way, Wisconsin's choice must be respected." *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496, 502 (7th Cir.), *cert. denied*, 110 S. Ct. 367 (1989) (upholding the Wisconsin statute).

133. Coffee, *supra* note 10, at 99. Schumann cites several recent examples of takeovers succeeding in the face of business combination statutes: *Amber Acquisition Corp.*

viewed a business combination statute, preliminary analysis suggests such a statute will survive constitutional challenge.<sup>134</sup>

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and Heileman Brewing Co.; Bilzerian Partners Ltd. and Singer Corp.; Salant Acquisition Corp. and Manhattan Industries Inc. See Schumann, *supra* note 85, at 200 n.10.

134. Whether or not these statutes are ultimately compatible with the Supreme Court's ruling in *CTS* on the constitutionality of control share acquisition statutes is an open issue beyond the scope of this Note. Nevertheless, the basic outline of the constitutional challenges to business combination statutes, and the Seventh Circuit's response regarding Wisconsin's statute in *Amanda Acquisition* do merit some discussion here.

One can object, on preemption grounds, that the board's de facto veto power over tender offers alters the Williams Act's neutrality in favor of incumbent management. Note, *supra* note 8, at 169-70. One can also argue that, in making tender offers unattractive to many potential bidders, such a statute is preempted by the Williams Act, if the Act is read as creating a right for investors to receive the benefit of tender offers. Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203, 231-36 (1987) (authored by James R. Pagano). Using a commerce clause analysis, Bamonte argues that the chilling effect of the post-acquisition moratorium constitutes a substantial burden on interstate commerce by injuring investors, the bulk of whom live outside of the state. Bamonte, *The Dynamics of State Protectionism: A Short Critique of the CTS Decision*, 8 N. ILL. U.L. REV. 259, 266-68 (1988).

*Amanda Acquisition* responds to several of these concerns in a manner quite favorable to advocates of state takeover legislation. Judge Easterbrook's basic conclusion is that because the Wisconsin statute does not alter the process of tender offers, it does not conflict with the Williams Act by possibly making Wisconsin a less attractive place in which to launch takeover bids. *Amanda Acquisition*, 877 F.2d at 505. The Williams Act does not create a right for investors to receive tender offers, nor does it confer a right upon bidders to profit by them. *Id.* at 504.

For the view that a proper understanding of the Williams Act offers no credible support to the preemption challenge to business combination statutes, see Johnson & Milon, *Misreading the Williams Act*, 87 MICH. L. REV. 1862, 1868 (1989); see also Boyer, *When It Comes to Hostile Tender Offers, Just Say No: Commerce Clause and Corporation Law in CTS Corp. v. Dynamics Corp. of America*, 57 U. CIN. L. REV. 539, 594 (1988) (stating that business combination statutes "may be unassailable under the specific holding of *CTS*," despite the increase in a target management's power, because the Court in *CTS* approved director approval of a hostile bid, as opposed to a subsequent shareholder vote, "as an alternative safeguard against coercive bids").

With regard to the commerce clause, *Amanda Acquisition* follows the approach, suggested in Justice Scalia's *CTS* concurrence, *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 94-97 (1987) (Scalia, J., concurring), of de-emphasizing an "unfocused" balancing test in favor of examining whether the statute discriminates on the basis of state boundaries. See *Amanda Acquisition*, 877 F.2d at 506-07. The Wisconsin statute, WIS. STAT. ANN. § 180.726 (West Supp. 1989), like the Indiana statute in *CTS*, is indifferent to the domicile of the bidder, and therefore not susceptible to attack on commerce clause grounds. See Grippo, *supra* note 3, at 289-90. For a brief discussion of constitutional issues unique to Delaware's statute, see *supra* note 127.

For a general overview of the constitutional issues involved in state takeover regulation, see Kozyris, *Corporate Takeovers at the Jurisdictional Crossroads: Preserving State Authority Over Internal Affairs While Protecting the Transferability of Interstate Stock Through Federal Law*, 36 UCLA L. REV. 1109 (1989); Pinto, *The Constitution and the Market for Corporate Control: State Takeover Statutes after CTS Corp.*, 29 WM. & MARY L. REV. 699 (1988); Comment, *State Takeover Legislation: The Extent of the States' Rights in the Creation of Control Share Acquisition Statutes*, 42 SW. L.J. 865 (1988) (authored by Mark S. Howard).

Whether business combination statutes, or state takeover regulation in general, actually protect nonshareholder interests is an empirical question that has received little attention. In the case of New York, the legislature explicitly premised its business combination statute on findings that out-of-state takeovers had often resulted in the liquidation or relocation of New York assets, which meant lost jobs, lost taxes, and depressed local economies.<sup>135</sup>

There is some concern, however, that strong protectionist forces can lead to laws that entrench the management of large, politically influential local corporations.<sup>136</sup> Business combination statutes, in restoring to the board a role in the negotiations, are uniquely vulnerable to that objection. Any attempt to strengthen the boards' capacity to function as a voice for nonshareholders inevitably runs the risk of increasing the potential for management entrenchment.

According to one commentator, three features of the market for control have strong political ramifications at the state level, creating "nearly irresistible" pressure for pro-management, anti-takeover legislation.<sup>137</sup> First, the immediate, wrenching socioeconomic costs of takeover activity are borne by a localized few, while the benefits are long-term and spread over the national economy.<sup>138</sup> Second, local business interests often wield substantial political power.<sup>139</sup> Third, the market in corporate charters exerts a heavy influence on states eager for incorporation fees to pass laws favorable to incumbent management.<sup>140</sup> An additional concern is that, although there is no evidence that friendly changes of control result in substantially less economic dislocation, state takeover statutes uniformly focus on hostile changes of control.<sup>141</sup>

In response, it is necessary to point out that simply because costs are borne by a localized few does not diminish the legitimacy of a state's concern for "its few." This is particularly true when some of the benefits that flow to the national economy may be wealth transfers from these local nonshareholder constituencies.

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135. See N.Y. BUS. CORP. LAW § 1612, Historical Note; Johnson & Millon, *supra* note 28, at 850; Note, *supra* note 119, at 1119.

136. Booth, *supra* note 10, at 1635.

137. Bamonte, *supra* note 134, at 261-63.

138. *Id.* at 262.

139. *Id.*

140. *Id.*

141. *Id.* at 263.

Furthermore, three factors mitigate concern for local businesses' political clout and the effects of the race to the bottom in state corporation codes. First, in extreme cases where the protectionist motive is quite strong, it is likely that the statute would not pass constitutional muster under the commerce clause.<sup>142</sup> Second, a board's actions under any form of state takeover statute would still be subject to judicial review. The courts are no strangers to the scrutiny of a board's defensive action for entrenchment motives, and statutes which permit non-shareholder interests to be considered only provide one more motive into which the courts will probe.<sup>143</sup> Third, the rapid pace of change in the nature of takeover defenses and the variations in state law that are in part a reaction to this frenzied change are persuasive reasons why regulation of this area should remain with the states. States have long-standing experience with corporate governance and the law of fiduciary duty; they are ideally poised to provide a good balance of continuity, stability and adaptation to change within their jurisdiction.<sup>144</sup>

Finally, the focus in state takeover statutes on hostile changes of control further demonstrates the legitimacy and need for the state's intervention. In friendly changes of control, the board of directors will play a significant role. There is no danger that the forum for nonshareholder concerns will be sidestepped by the very structure of the transaction, as is the case in a hostile tender offer directly to the shareholders.

Professor Romano, in one of the few systematic attempts to research the political history of a state takeover statute, found that in the case of Connecticut's fair price provision, there did not appear to be evidence supporting a coalition theory for the passage of the law.<sup>145</sup> On the contrary, the main impetus for the legislation was the Aetna Life and Casualty Insurance Company, one of the state's largest corporations.<sup>146</sup> It would be premature to conclude on the basis of this finding that state takeover laws are irredeemably protectionist. To begin with, Connecticut's experience is not representative, for the simple reason that it con-

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142. Coffee, *supra* note 10, at 101.

143. Shipman, *supra* note 10, at 537. For the view that the business judgment rule is by its nature too protective of incumbent management, see Farrar, *supra* note 80, at 39-40; Davis, *supra* note 3, at 511-12.

144. Shipman, *supra* note 10, at 537-38.

145. Romano, *supra* note 12, at 122-23, 136; see also Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 U. CIN. L. REV. 457 (1988); Macey, *supra* note 8, at 470; Note, *supra* note 8, at 170-71.

146. Romano, *supra* note 12, at 123.

cerns a fair price statute.<sup>147</sup> Because a fair price provision is not designed to protect nonshareholder interests in the event of a takeover, a lack of interest on the part of nonshareholder groups cannot indict the thesis that state takeover laws, particularly business combination statutes, are responsive to nonshareholder interests. Furthermore, as Romano herself points out, it is possible that the legislators who passed the bill had nonshareholder effects in mind.<sup>148</sup>

## V. CONCLUSION

When Berle and Means first publicized the separation of ownership and control in modern publicly held corporations, they could hardly have foreseen either the dramatic increase in takeovers, which is a consequence of this separation, or the effect this would have on the fabric of corporate governance. Nevertheless, in maintaining that the proprietary nature of stock ownership was seriously undermined by this separation, they predicted the advent of the modern shareholder who facilitates the takeover market as a largely passive investor.

In identifying the normative gulf created by this revolution in ownership, Berle and Means set for corporate law the task of formulating a suitable norm for exercising and monitoring control. The ambiguity surrounding the fiduciary duty of a target board is illustrative of the complexity of this task. As evidenced by state statutes and case law, the interests of nonshareholders are within the scope of this duty. This strongly suggests that, whatever the precise formulation of the corporate norm, it is most certainly not exclusively shareholder wealth maximization, as takeover advocates would present it.

In attempting to resolve conflicts between management and shareholders, the market for control has highlighted a second set of conflicts between shareholders and other stakeholders, who in many cases stand to lose as much as, or more than, the shareholders stand to gain. This fact reflects the shortsightedness of

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147. For example, Wisconsin's experience with its control share acquisition statute supports the coalition theory. The statute, sponsored by the state administrative agency entrusted with protecting shareholders, enjoyed widespread and broad-based support, both in the Democratic legislature and throughout the state. Davis, *supra* note 3, at 492-99. Generally, "many at the state level sincerely see these statutes as necessary to protect the long-accepted allocation of claims against the corporation—not only those of management and shareholders, but those of employees and communities as well—from the disruptive effects of what is perceived as market caprice." *Id.* at 499.

148. Romano, *supra* note 12, at 135.

arguments for a deregulated market for control that focus exclusively on shareholder wealth maximization. These calls for deregulation mischaracterize the corporate norm and ignore the legitimate need of nonshareholders for protection from shareholder overreaching.

State takeover statutes have the strongest claim to legitimacy when they are structured in response to this need for protection. The business combination statute, by restoring the board to an active role in takeover negotiation, can best meet this need. Bidding corporations would have to reach an accommodation with the board, which, according to corporate law and policy, would require that provision be made for nonshareholders. Corporations failing to reach such an accommodation would face severe restrictions on their manipulation of the target's assets. Business combination statutes, reflecting the state's concern for both the interests of its nonshareholding constituencies and the board's responsibility to protect these interests, are the most effective and defensible way for states to protect nonshareholder interests in takeover contests.